STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
HOME DEPOT U.S.A., INC.	:	DETERMINATION DTA NO. 821034
for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period March 1, 1997 through July 31, 2003.	:	

Petitioner, Home Depot U.S.A., Inc., 2455 Paces Ferry Road N.W., Atlanta, Georgia 33039-4024, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period March 1, 1997 through July 31, 2003.

Petitioner, by its representative, Morrison & Foerster, LLP (Amy F. Nogid, Esq., of counsel), brought a motion filed December 8, 2006, seeking summary determination in the above- referenced matter pursuant to Tax Law § 2006(6) and 20 NYCRR 3000.9(b). The Division of Taxation appeared in opposition to the motion by its representative, Daniel Smirlock, Esq. (James Della Porta, Esq., of counsel). The parties completed their submission of briefs by February 20, 2007, which date began the 90-day period for issuance of this determination. On April 24, 2007, on notice to the parties, the date for issuance of this determination was extended from 90 days to six months from February 20, 2007, pursuant to 20 NYCRR 3000.5(d).

After due consideration of the motion and the supporting affidavit of Amy F. Nogid, Esq., sworn to on December 7, 2006, and the exhibits attached thereto, and all the pleadings and proceedings had herein, Joseph W. Pinto, Jr., Administrative Law Judge, renders the following determination.

ISSUES

I. Whether the Division of Taxation properly denied petitioner's claim for refund of sales and use taxes paid on transactions which were financed by third parties and subsequently were ascertained to be uncollectible.

II. Whether the Division's regulation at 20 NYCRR 534.7(b)(3) should be determined to be invalid due to an inconsistency with the intent of Tax Law § 1132(e).

III. Whether petitioner is entitled to equitable relief if it is found that the State of New York is being unjustly enriched, contrary to the spirit and intent of Tax Law § 1132(e).

IV. Whether the Division of Taxation has violated petitioner's right to equal protection of the laws and its right to due process under the Federal and New York State constitutions by failing to refund the sales and use taxes remitted by petitioner.

FINDINGS OF FACT

The parties entered into a Stipulation of Facts containing 33 numbered findings which have been included in the findings of fact below.

1. Home Depot U.S.A., Inc. ("Home Depot") is a Delaware corporation headquartered in Atlanta, Georgia, which operated retail home improvement centers throughout the United States, including New York, during the period March 1, 1997 through July 31, 2003 (the "audit period").

2. During the audit period, Home Depot provided its customers with the option of purchasing merchandise through a private label credit card.

3. Home Depot entered into an Amended and Restated Consumer Credit Card Program Agreement with Monogram Credit Card Bank of Georgia ("Monogram"), dated August 4, 1997, to issue and finance Home Depot private label credit cards to consumers. In addition, Home

Depot entered into an Amended and Restated Commercial Credit Program Agreement and an Amended and Restated Business Credit Card Program Agreement with General Electric Capital Corporation ("GECC"), both dated August 4, 1997, to issue and finance Home Depot private label credit cards to commercial businesses. Hereinafter, all three agreements are referred to collectively as the "Credit Card Program Agreements." The Credit Card Program Agreements were complete documents reflecting the furnishing of private label credit card programs to Home Depot.

4. Monogram and GECC applied creditworthiness standards to the applications, issued to qualified customers private label credit cards bearing the "Home Depot" name and entered into credit card agreements with these customers. Monogram and GECC, in their sole discretion, determined the creditworthiness of all individual applicants for credit cards.

5. During the period in issue, Home Depot did not have an equity interest in either Monogram or GECC.

6. Home Depot was a vendor of tangible personal property or services as defined in Tax Law § 1131(1), was registered to collect New York State and local sales tax as required by Tax Law § 1134 and remitted sales tax to the Division of Taxation ("Division") on New York sales based on the full purchase price of taxable merchandise, including credit card sales of merchandise.

7. For each sale made to a customer using the Home Depot private label credit card, Monogram or GECC paid to Home Depot the purchase price and sales tax less a credit card service fee as provided in the Credit Card Program Agreements. The service fee varied depending on the type and amount of the sales transaction financed.

8. Home Depot recorded an accounts receivable from Monogram or GECC related to each sale subject to a Credit Card Program Agreement, but did not record an account receivable from the customer with respect to such credit card transactions.

9. Although not specified in the Credit Card Program Agreements, the parties agreed that the credit card service fees were determined by several factors, including the bad debt experience of Home Depot's credit card customers, the interest income that Monogram or GECC anticipated it would earn and that Home Depot forwent on the credit card account, the value of Home Depot's credit card database given to Monogram and GECC, and the administrative costs associated with the managed credit accounts by Monogram and GECC.

10. Home Depot compensated Monogram and GECC in advance for anticipated bad debts through the credit card service fee. The actual bad debts written off by Monogram and GECC may have been equal to, greater than or less than the anticipated bad debts.

11. Eugene J. Thorncroft, Jr., Vice President of Risk Management for Monogram, who had knowledge of Monogram's financing of credit sales by Home Depot, attested that the negotiated purchase price of the accounts included an undisclosed bad debt loss component, among other costs and considerations listed above, which represented retention of an economic risk of loss on the accounts receivable by Home Depot.

12. The agreement between Monogram and petitioner, dated August 4, 1997, specifically listed "service fee" in its definitions, section 1.01, defining it as the meaning given in section 5.03(a), which merely said it was a fee applicable to all charge slips in the charge transaction data as indicated in an attached schedule (Schedule 5.03) which did not mention the components of the service fee.

In addition, the same agreement stated in section 6.02 that all credit losses on accounts were to be borne at the expense of Monogram and not passed on to petitioner except in chargeback situations not present herein.

The terms of the agreement with GECC were substantially similar, reflecting no explanation of the service fee and specifically indicating that losses on the accounts were borne by GECC and not passed on to petitioner.

The parties stipulated that to the extent anything in the stipulation contradicted the terms of the credit card agreements, the terms of the agreements controlled.

13. Home Depot deducted the credit card service fees for Federal income tax purposes on line "26" ("Other Deductions") of its Federal corporation income tax forms (forms 1120) but did not deduct the bad debts attributable to the Home Depot credit cards issued by Monogram or GECC on line 15 ("Bad Debts") of its Federal income tax returns (forms 1120).

14. Certain of the receivables related to sales made by Home Depot to its customers using the Home Depot private label credit card became worthless and uncollectible.

15. On December 13, 2003, petitioner filed three timely refund claims with the Division. One claim, for the period March 1, 1997 through February 28, 2000, requested a refund of $1,553,753.67 ("First Refund Claim"). The second refund claim, for the period March 1, 2000 through November 30, 2001, requested a refund of $1,643,593.81 ("Second Refund Claim"). The last claim, for the period December 1, 2001 through July 31, 2003, requested a refund of $2,573,056.61 ("Third Refund Claim"). The refund claims pertained to sales taxes paid by petitioner with respect to credit card sales, the receivables for which became uncollectible.

16. On December 28, 2004, the Division denied the First Refund Claim in its entirety.

17. On March 25, 2005, petitioner timely filed its Request for Conciliation Conference with respect to the December 28, 2004 refund denial.

18. The Division consolidated for review the Second Refund Claim and the Third Refund Claim, and on May 10, 2005, the Division issued one letter denying both refund claims in their entirety.

19. On August 3, 2005, petitioner timely filed its Request for Conciliation Conference with respect to the Division's denial of its Second and Third Refund Claims. On December 16, 2005, the Bureau of Conciliation and Mediation Services issued two conciliation orders denying both of petitioner's requests for relief.

20. In its refund denial letters, the Division did not take issue with the bad debts underlying the refund claims. Instead, the Division based its denial on 20 NYCRR 534.7(b)(3) which prohibited generally a refund of sales tax for transactions which were financed by a third party or for a debt which had been assigned to a third party regardless of whether the third party had recourse to the vendor on the debt.

21. Home Depot provided substantiation to the Division detailing the actual worthless transactions underlying its refund claims.

22. Pursuant to the terms of their credit card agreements with Home Depot, Monogram and GECC own the Home Depot credit card accounts, and because of this, they recorded the receivables related to such accounts on their balance sheets.

23. For Federal income tax purposes, Monogram and GECC wrote off receivables, including those related to their credit card agreements with Home Depot, after they became uncollectible, and claimed a deduction on line "15" ("Bad Debts") on their Federal corporation income tax returns, as permitted by Internal Revenue Code § 166.

24. If either Monogram or GECC had filed claims for refund of sales taxes related to the sales made by Home Depot to customers using the Home Depot private label credit cards which became worthless and uncollectible, and which are the subject of this case, the Division would have denied those claims as well, consistent with the New York Court of Appeals decision in ***Matter of General Electric Capital Corp. v. New York State Division of Tax Appeals*** (2 NY3d 249, 778 NYS2d 412).

25. The parties stipulated that, if it is determined that petitioner is entitled to a refund of the sales taxes paid with respect to sales subject to the Credit Card Program Agreements, the amounts claimed by it in its First and Second Refund Claims will be refunded.

SUMMARY OF THE PARTIES' POSITIONS

26. Petitioner argues that the Division's regulation at 20 NYCRR 534.7(b)(3), which was the basis for the Division's denial of petitioner's refund claims, conflicts with the statute pursuant to which it was promulgated, Tax Law § 1132(e), because it prohibits the refund of sales tax paid on purchases by bad debtors merely because the retailer entered into a financing arrangement with a third-party credit card bank. Petitioner believes the regulation's prohibition was unreasonable, arbitrary and restrictive. The result of the Division's interpretation of Tax Law § 1132(e), which provided an exclusion from taxable receipts for receipts that proved uncollectible, was that the Division received a windfall which was not intended by the statute.

27. Petitioner contends that the Division's interpretation of Tax Law § 1132(e) increased the effective tax rate and, therefore, must be found invalid. Further, by depriving petitioner of a refund of the sales tax paid on uncollectible sales, petitioner argues that the regulation shifted the financial burden for the tax from the purchaser to the vendor in contravention of the statute.

28. Petitioner maintains that recently enacted legislation, which explicitly provides that the vendor or the issuer of its private-label credit card may receive refunds on that portion of any such credit card account that is worthless and has been taken as a loss on Federal income taxes, should be considered when determining the intent of the earlier legislation.

29. Finally, petitioner believes that since the Division's denial of its refund requests resulted in an unjust enrichment of the State it should prevail herein on the basis of fairness, i.e., equity. In addition, by treating similarly situated taxpayers differently, the Division has violated petitioner's right to equal protection of the laws, and the denial of its refund requests resulted in a denial of petitioner's due process.

30. The Division contends that pursuant to the decision in ***Matter of General Electric Capital Corp., (supra)***, the permissive language in Tax Law § 1132(e) which states that "the tax commission may provide, by regulation," for a refund of sales taxes paid on sales where the receipt has been ascertained to be uncollectible, does not require the Division to grant such refunds to any class of applicants. In other words, the Division believes it has discretion to determine the scope of the credit it will allow. Since the regulation it promulgated pursuant to Tax Law § 1132(e) prohibited a refund or credit in transactions financed by third parties, petitioner was not eligible for the refund it seeks. As such, the regulation was consistent with the statute's intent and within the statutory grant of power to the agency.

31. The Division also argues that it is an impossibility to determine which parties assumed the full economic burden for the bad debts and to what extent, underscoring the reasonableness of the regulation in issue.

32. The Division contends that the equities of the tax scheme in issue have no bearing on the legal issue and it cannot be assumed that the Legislature intended the result of its statutory enactment to be a fair and balanced formula.

33. The Division believes that the enactment of chapter 664 of the Laws of 2006, which provided for a sales tax bad debt credit when a sale is financed by a third party supports its position herein. It notes that the legislation specifically is not retroactive and also points out that the sponsor's memorandum candidly laments the failure of the prior law to provide such relief.

CONCLUSIONS OF LAW

A. Tax Law § 1132(e) states, in pertinent part, as follows:

> The Tax Commission may provide, by regulation, for the exclusion from taxable receipts . . . of amounts representing sales where . . . the receipt . . . has been ascertained to be uncollectible or, in case the tax has been paid upon such receipt, for refund of or credit for the tax so paid.

B. In fact, consistent with the explicit grant of authority set forth in Tax Law §1132(e), the Commissioner of Taxation and Finance promulgated 20 NYCRR 534.7(b)(1), which states that "[w]here a receipt . . . has been ascertained to be uncollectible, either in whole or in part, the vendor of the tangible personal property . . . may apply for a refund or credit of the tax paid on such receipt." The same regulation, however, provides that a refund or credit is not available for a transaction which is financed by a third party or for a debt which has been assigned to a third party, regardless of whether the third party has recourse to the vendor on the debt. (20 NYCRR 534.7[b][3].)

C. The scenario where the debt has been assigned to a third party was specifically addressed by the Court of Appeals in ***Matter of General Electric Capital Corp. v. New York State Division of Tax Appeals*** (***supra***), wherein the Court upheld the Division's denial of refund claims based upon its finding that Tax Law § 1132(e) granted the commissioner the authority to

promulgate regulations regarding uncollectible debts and placed no limitations on the commissioner's power to determine the types of parties that could qualify for tax refunds on uncollectible debts. In addition, the Court found that the commissioner's preclusion of refunds for parties that had not paid the taxes and were removed from the taxable transaction was necessary to avoid excessive administrative burdens and facilitate the orderly administration of the sales tax.

It is concluded that the Court's rationale is applicable to the instant matter, and it is determined that the commissioner acted within the power and authority granted to him by Tax Law § 1132(e) in denying petitioner's refund claims herein. Just as the petitioner in ***General Electric*** conceded its refund claim fell within the prohibition of 20 NYCRR 534.7(b)(3) but argued that said restriction was not authorized by the statute, so too does Home Depot claim that the regulation's prohibition as applicable to this matter was unreasonable, arbitrary and restrictive. It is determined that was not the case.

C. The Court in ***General Electric*** noted:

> The cornerstone of administrative law is derived from the principle that the legislature may declare its will, and after fixing a primary standard, endow administrative agencies with the power to fill in the interstices in the legislative product by prescribing rules and regulations consistent with the enabling legislation . . . . In so doing, an agency can adopt regulations that go beyond the text of that legislation, provided they are not inconsistent with the statutory language or its underlying purposes. [Citations omitted.]
>
> This regulatory authority is, of course, not unbridled. 'As an arm of the executive branch of government, an administrative agency may not, in the exercise of rule-making authority, engage in broad-based public policy determinations' [citation omitted] and may adopt only rules and regulations which 'are in harmony with the statute's over-all purpose.' [Citation omitted.] That being said, where an agency adopts a regulation that is consistent with its enabling legislation and is not "so lacking in reason for its promulgation that it is essentially arbitrary" [citation omitted] the rule has the force and effect of law. [Citation omitted.] ***(Matter of General Electric Capital Corp. v. New York State Division of Tax Appeals***, ***supra***, at 254, 778 NYS2d at 415.).

The Court in ***General Electric*** determined that Tax Law § 1132(e) permitted but did not require the Division to provide refunds for sales taxes paid on uncollectible debts and left to the discretion of the Department of Taxation and Finance the formulation of regulations which would delineate the situations, if any, where uncollectible debts would be excluded from taxable receipts. The Division's regulation at 20 NYCRR 534.7(b) was found to be consistent with this charge, identifying the entities eligible to apply for the refund and under what circumstances a refund would be granted.

The Division's regulation which specified which entities would be permitted to seek refunds of the sales tax was necessary to avoid an excessive administrative burden and accomplish an orderly administration of the sales tax. The Court of Appeals in ***General Electric*** considered this in the context of the sales tax statutory scheme and came to the conclusion that, since retail vendors were in a special trustee relationship with the State and were subject to specific registration and record-keeping requirements, the fact that the Division granted them the benefit of a refund on sales taxes for uncollectible debts was clearly rational given the responsibilities imposed on vendors and to foster the trustee relationship with the State, encouraging accurate reporting of taxable sales and payment of taxes in a timely manner.

Finally, it was determined in ***General Electric*** that Tax Law § 1132(e) did not limit the commissioner's power to determine the types of entities that qualified for the benefit (i.e., excluding uncollectible debts from taxable receipts). As a result, the Division's refusal to grant a refund to an entity that never paid taxes and was removed from the underlying taxable transaction was deemed both rational and consistent with Tax Law § 1132(e).

D. The same rationale is controlling in this matter. Petitioner made taxable sales of tangible personal property or services which customers purchased using Home Depot private

label credit cards supplied by either Monogram or GECC. The credit card companies paid petitioner the full amount of the receipt and the sales tax. Petitioner accepted the sales tax as the trustee for the State of New York and paid it over to the Division with its returns.

In consideration of the services provided to petitioner, the credit card companies subtracted from all receipts a service charge. The service charge was not specifically defined in either the GECC or Monogram contract, except to say that it was calculated in accordance with a formula set forth in an appendix. The parties to this matter stipulated that the service fees were determined by several factors, including the following: the bad debt experience of Home Depot's credit card customers; the interest income that Monogram or GECC anticipated they would earn and that Home Depot forwent on the credit card account; the value of Home Depot's credit card database given to Monogram and GECC; and the administrative costs associated with the managed credit accounts by Monogram and GECC. However, it is particularly noteworthy that neither the agreements nor the stipulation apportioned the percentages of the service fee among the various components and that petitioner conceded it could not determine if the actual bad debts written off by Monogram and GECC were equal to, greater than or less than the anticipated bad debt figure used to estimate the bad debt component of the service fee. In sum, petitioner did not demonstrate and acknowledged that it could not accurately account that it had compensated GECC or Monogram for the accounts which ultimately became uncollectible.

It is also pertinent that the credit card companies emphatically stated in their agreements with petitioner that all credit losses on accounts were to be borne at the expense of Monogram and GECC and not passed on to petitioner except in chargeback situations not present herein. In turn, the credit card companies, not petitioner, then reported the bad debts as losses on their Federal corporate income tax returns, an acknowledgment that GECC and Monogram incurred

the losses in form as well as in economic substance. It was not the intent of the parties that petitioner would share in the losses which GECC and Monogram represented to the Internal Revenue Service they had incurred. Indeed, if petitioner's characterization of the circumstances were adopted, the losses reported by the credit card companies on their Federal income tax returns would have been in bad faith since, according to petitioner, the bad debts had been reimbursed. Further, petitioner's argument creates the untenable circumstance where deductions for bad debts and service fees are taken by both parties with no corresponding income reported. This argument is contrary to the plain meaning of the terms of the agreements with the credit card companies, which specifically provided that all credit losses on accounts were to be borne at their expense and not passed on to petitioner. That the parties agreed that the terms of the agreements superseded any facts in the stipulation is further support for this conclusion.

E. Assuming arguendo that part of the service fee was dedicated to uncollectible accounts, petitioner has unequivocally stated that it did not know if the amount corresponded with the amount of bad debts, thus conceding it was not possible to trace the amounts stated on specific receipts to its refund claims. In addition, as pointed out by the Court of Appeals in the ***General Electric*** decision, the limitations imposed by the commissioner in 20 NYCRR 534.7(b)(3) were "necessary to avoid excessive administrative burden and facilitate the orderly administration of the sales tax." Since petitioner conceded it could not trace the source of the refund claims with specificity, a burden the Tax Law lays squarely on its shoulders, certainly the Division could not be expected to do so on audit.

F. Both parties have pointed out that Tax Law § 1132 was amended by chapter 664 of the Laws of 2006 to provide that where accounts are held by a lender, either the vendor or the lender, after filing an election with the Department designating which party is entitled to claim

the refund or deduction for bad debt, shall be entitled to a deduction or refund of tax that the vendor has previously reported and paid. (Tax Law § 1132[e-1][3][i], effective January 1, 2007.)

The Division contends that the statutory change was not retroactive and was enacted to address a change in industry custom with respect to the use of third-party finance companies. Petitioner argues that the change was a clear invalidation of the Division's regulation at 20 NYCRR 534.7(b)(3) and overruled the ***General Electric*** decision. In essence, petitioner believes the amendment, effective in January 2007, demonstrated that the Legislature believed the Division's interpretation was improper and unreasonable *ab initio* and supports its interpretation of Tax Law § 1132(e) vis-a-vis its entitlement to the refunds herein.

There is a general presumption that statutes operate prospectively. (McKinney's Cons Laws of NY, Book 1, Statutes § 51[c].) This is equally true for amendatory statutes unless their language clearly indicates a contrary interpretation. (McKinney's Cons Laws of NY, Book 1, Statutes § 52.) The amendment to Tax Law § 1132 contains no such language and the Introducer's Memorandum in Support of S.6541, containing the amendments, provides no support for such an interpretation. In fact, the Memorandum cites the same rationale as petitioner, i.e., that industry customs have changed and that the amendment was necessary to reflect the business environment as it now exists, with retailers turning to third-party financing partners. The tone of the Memorandum and the consistent rationale for the amendment was clearly prospective in its curative objectives. Even petitioner seems to endorse this conclusion when it opined in its reply brief that "[t]he new legislation merely confirms that there can be no reasonable **continuing** policy justification for 20 NYCRR 534.7(b)(3)," intimating that there had been a valid policy justification prior to the enactment of the amendment.

Therefore, the rationale of the ***General Electric*** decision and the interpretation of the regulations discussed above remain valid as applied to the facts and circumstances in the periods at issue herein. Consistent with this analysis and conclusion, petitioner's contention that the Division's denial of the refund claims was contrary to the spirit of the law and worthy of equitable relief is determined to be without merit.

G. The Fourteenth Amendment to the United States Constitution provides that no state shall "deny to any person within its jurisdiction the equal protection of the laws." Similarly, New York's Constitution provides that "no person shall be denied the equal protection of the laws of this state or any subdivision thereof" (NY Const, art I, § 11).

The Equal Protection clauses of the State Constitution and Federal Constitution do not forbid classifications, but simply prohibit governmental decision makers from treating differently persons *who are in all relevant respects alike.* Petitioner is not in all respects like a vendor who finances a sale. It did not maintain accounts receivable for its customers and did not incur bad debts when customers defaulted on their payments for property and services purchased from petitioner. In fact, petitioner received the purchase price and tax thereon, in full, from the credit card companies, less the service charge. There was a very strong policy reason for treating petitioner differently from vendors who financed sales themselves, and as a result, petitioner's equal protection claim must fail.

Further, although not argued by the parties, petitioner voluntarily chose to do business in this fashion, albeit in step with industry custom. Since the form of the transaction (third-party financing) was chosen by petitioner with knowledge of the regulation, 20 NYCRR 534.7(b)(3), petitioner is bound by that choice and its ramifications. "The choice of form did not rest with the tax authorities but with the taxpayer. If he unfortunately chose a form which was taxable instead

of an equally available form which was non-taxable, he must bear the consequences" (***Matter of Sverdlow v. Bates,*** 283 App Div 487, 129 NYS2d 88, 91-92; ***see also***, ***Matter of North Shore Cadillac v. Tax Appeals Tribunal***, 13 AD3d 994, 787 NYS2d 463, ***lv denied*** 5 NY3d 704, 801 NYS2d 1).

H. Likewise, petitioner's argument that the Division's refund denials were so unduly harsh or oppressive that they amounted to a denial of petitioner's due process rights under the Fourteenth Amendment of the US Constitution and article 1 (§ 6) of the New York Constitution is without merit. Petitioner voluntarily chose the form of its business transactions and was aware of the regulatory prohibition of refunds thereon. Given the conclusions reached above, the regulations were consistent with the enabling legislation and the refund denials proper.

I. For the reasons stated, petitioner's motion for summary determination pursuant to 20 NYCRR 3000.9(b) is denied. However, it is further determined that given the facts, analysis and conclusions reached above, and there being no material and triable issue of fact, summary determination in the Division of Taxation's favor is warranted as a matter of law, without the necessity of a cross-motion. (20 NYCRR 3000.9[b][1].)

J. The petition of Home Depot U.S.A., Inc., is denied, the Division of Taxation's denials of petitioner's refund claims, dated December 28, 2004 and May 10, 2005, are sustained, and summary determination is granted in the Division of Taxation's favor.

DATED: Troy, New York
May 17, 2007

/s/ Joseph W. Pinto, Jr.
ADMINISTRATIVE LAW JUDGE